

TAX CONVENTION WITH THE REPUBLIC OF
TUNISIA, WITH SUPPLEMENTARY PROTOCOL

R E P O R T

OF THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

ON

TREATY DOCUMENTS 99-13, 99TH CONGRESS, 2D SESSION AND 101-
9, 101ST CONGRESS, 2D SESSION, TAX CONVENTION WITH TUNI-
SIA, WITH SUPPLEMENTARY PROTOCOL



JULY 27 (legislative day, JULY 10), 1990.—Ordered to be printed

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Mr. PELL, from the Committee on Foreign Relations,
submitted the following

REPORT

[To accompany Treaty Docs. 99-13, 99th Congress, 2d Session and 101-9, 101st Congress, 2d Session]

The Committee on Foreign Relations, to which was referred the Convention between the Government of the United States of America and the Government of the Tunisian Republic for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, together with an exchange of notes, signed at Washington on June 17, 1985, and a supplementary protocol, signed at Tunis on October 4, 1989, having considered the same, reports favorably thereon and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

The principal purposes of the proposed income tax treaty between the United States and the Republic of Tunisia ("Tunisia") are to reduce or eliminate double taxation of income earned by citizens and residents of either country from sources within the other country, and to prevent avoidance or evasion of the income taxes of the two countries. The proposed treaty is intended to promote closer economic cooperation between the two countries and to eliminate possible barriers to trade caused by overlapping taxing jurisdictions of the two countries. It is intended to enable the countries to cooperate in preventing avoidance and evasion of taxes.

II. BACKGROUND

The proposed treaty with Tunisia was signed on June 17, 1985. The proposed treaty was amplified by an exchange of notes signed the same day. The supplementary protocol to the proposed treaty

was signed on October 4, 1989. Presently, there is no income tax treaty in effect between the United States and Tunisia.

The proposed treaty was transmitted to the Senate for advice and consent to its ratification on March 13, 1986. The supplementary protocol was transmitted to the Senate for advice and consent to its ratification on January 24, 1990. The proposed treaty and supplementary protocol were the subject of a hearing before the Committee on Foreign Relations on June 14, 1990.

III. SUMMARY

The proposed treaty and protocol are similar to other recent U.S. income tax treaties, the 1981 proposed U.S. model income tax treaty (the "U.S. model"), and the model income tax treaty of the Organization for Economic Cooperation and Development (the "OECD model"). However, there are certain deviations from those documents.

As in other U.S. tax treaties, the objectives of the proposed treaty are achieved principally by each country agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other country. For example, the proposed treaty provides that a country will not tax business income derived from sources within that country by residents of the other country unless the business activities in the first country are substantial enough to constitute a permanent establishment or fixed base (Articles 7 and 14). Similarly, the proposed treaty contains "commercial visitor" exemptions under which residents of one country performing personal services in the other country are not required to pay tax in the other country unless their contact with that other country exceeds specified minimums (Articles 14, 15, 17, and 20). The proposed treaty provides that dividends, interest, royalties, and certain gains derived by a resident of either country from sources within the other country generally are taxable by both countries (Articles 10, 11, 12, and 13). However, dividends, interest, and royalties received by a resident of one country from sources within the other country generally are to be taxed by the source country on a restricted basis (Articles 10, 11, and 12).

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, relief from the potential double taxation generally is provided for by the country of residence allowing a foreign tax credit (Article 23).

Like other U.S. tax treaties, the proposed treaty contains a "saving clause" (Article 22(2)). Under this provision, the United States generally retains the right to tax its citizens and residents as if the treaty had not come into effect. In addition, the proposed treaty contains the standard provision that it does not apply to deny a taxpayer any benefits he is entitled to under the domestic law of the country or under any other agreement between the two countries (Article 22(1)); that is, the treaty only applies to the benefit of taxpayers.

The proposed treaty also contains a non-discrimination provision (Article 24) and provides for administrative cooperation and exchange of information between the tax authorities of the two coun-

tries to avoid double taxation and to prevent fiscal evasion with respect to income taxes (Article 26).

The proposed treaty differs in certain respects from other U.S. income tax treaties and from the U.S. model and OECD model treaties. Some of these differences are as follows:

(1) The U.S. excise tax on insurance premiums paid to a foreign insurer is not covered by the proposed treaty. Although this is consistent with several older U.S. tax treaties, the U.S. model and some recent U.S. treaties, such as the treaties with the United Kingdom, France, and Hungary, generally cover this excise tax. In addition, the excise taxes imposed with respect to private foundations are not covered by the proposed treaty, although they are covered by the U.S. model.

(2) Under the U.S. model, the term "United States" is defined as the United States of America, but does not include any U.S. possession or territory. The proposed treaty's definition of this term extends beyond the definition stated in the U.S. model to include those parts of the adjacent seas over which the United States may, in accordance with international law, exercise rights with respect to the natural resources of the seabed and marine subsoil. However, the U.S. model definition is understood to also include these territories.

(3) U.S. citizens who are not treated as U.S. residents under the proposed treaty's residence rules (Article 4) generally are not covered by the proposed treaty. The U.S. model does cover such non-resident U.S. citizens; however, the United States rarely has been able to negotiate coverage for them in its income tax treaties. The proposed treaty treats the governments of the two countries as treaty country residents (i.e., it extends treaty benefits to each government), whereas the U.S. model makes no mention of the respective treaty countries' governments in its article on residence.

(4) Both the proposed treaty and the U.S. model provide that a person who is taxable under the laws of a country by reason of that person's residence is considered a resident of that country for treaty purposes. The proposed treaty limits the application of this rule, however, in the case of certain persons who are treated as U.S. residents under the Code. That provision states that a U.S. citizen or an alien admitted to the United States for permanent residence (i.e., a "green card" holder) is considered a resident of the United States for purposes of the proposed treaty only if that individual has a substantial presence, a permanent home, or an habitual abode in the United States.

(5) The U.S. model specifies that in the case of income earned by a pass-through entity (such as a partnership, estate, or trust), the entity will be treated as a resident of a treaty country only to the extent that the income derived by the entity is subject to tax in that country as the income of a resident, either in the hands of the entity or in the hands of the entity's partners or beneficiaries. The proposed treaty omits this language, but it is understood by the Committee that a similar rule will apply to income derived by partnerships. The Committee further understands that a similar rule regarding income earned by trusts or estates is not relevant to the proposed treaty because those entities are not recognized under Tunisian law.

(6) Under the U.S. model, a dual resident corporation is automatically considered a resident of the country under whose laws it was created and is, thus, entitled to only the treaty benefits that other corporate residents of that country receive.¹ By contrast, the proposed treaty provides that the determination of a single country of residence with respect to a dual resident company is effected through mutual agreement by the competent authorities of the two countries.

(7) The definition of a "permanent establishment" in the proposed treaty is broader, in certain respects, than the corresponding definitions in the U.S. model, the OECD model, and in many existing U.S. treaties. For example, the proposed treaty treats as a permanent establishment a building site, construction, assembly, or installation project, or an installation, drilling rig, or ship used for the exploration or exploitation of natural resources (or supervisory activities in connection therewith) that lasts for more than 183 days during any 365-day period. The U.S. and OECD models provide for a 12-month period before a permanent establishment is created in such cases (except that both models are silent with respect to certain related supervisory activities). Similar provisions reducing the 12-month threshold are found in some other U.S. tax treaties.

(8) The proposed treaty contains a provision, not found in either the U.S. or OECD model treaties, stating that an insurance company which is a resident of one of the countries is treated as having a permanent establishment in the other country if it uses an employee or other representative (other than a broker or independent agent acting in his or her ordinary course of business) in such other country for the purposes of receiving premiums from, or insuring risks in, that other country.

(9) The proposed treaty omits the standard treaty provision that provides investors in real property in the country not of their residence with an election to be taxed on a net basis with respect to income from such investments. Current U.S. law independently provides a net-basis taxation election to foreign persons (Code secs. 871(d) and 882(d)). Based on the Treasury's Technical Explanation, the Committee understands that, as a general rule, Tunisian law provides for taxation of income from real property on a net basis as well.

(10) The proposed treaty does not contain a definition of the term "business profits," although certain categories of business profits are defined in various articles. Many U.S. treaties and the U.S. model define business profits to include income from rental of tangible personal property and from rental or licensing of films or tapes. The proposed treaty, as amended by the proposed protocol, includes payments for the use of, or the right to use, industrial, commercial, or scientific equipment as royalties, which generally are subject to a 10-percent source-country withholding tax imposed on a gross basis. Furthermore, income from rental or licensing of films or tapes also is treated as royalties under the proposed treaty

¹ Under the OECD model, a dual resident corporation is considered a resident of the country in which its place of effective management is situated.

and protocol, subject to a 15-percent source-country withholding tax.

(11) The proposed treaty, the U.S. model, and the OECD model each permit a reasonable allocation to a permanent establishment of certain expenses (e.g., general and administrative expenses) incurred by worldwide operations of the person having the permanent establishment. Although the U.S. model makes specific reference to the allowance of deductions for certain general and administrative, research and development, and interest expenses, whether incurred in the country in which the permanent establishment is situated or otherwise, the proposed treaty and the OECD model specifically mention only general and administrative expenses in this context. In addition, unlike the two model treaties, but like the U.N. model, the proposed treaty specifically provides that no deduction is allowed with respect to amounts (other than reimbursements for actual expenses) paid by the permanent establishment to its home office or to any of its other offices as royalties, fees, etc.; in return for the use of patents or other rights; or as a commission for specific services performed or for management; or as interest on moneys lent to the permanent establishment. The proposed treaty also provides a reciprocal rule so that no consideration is given to the same types of payments made by the home office to the permanent establishment.

(12) The proposed treaty does not contain the usual treaty provision stating that the treaty is not intended to limit any law of either country which permits the distribution, apportionment, or allocation of income, deductions, credits, or allowances between related persons if such law is necessary to prevent evasion of taxes or to clearly reflect the income of such persons. This provision generally serves as clarification that the United States retains the right to apply its intercompany pricing rules (Code sec. 482) and its rules relating to the allocation of deductions (Code secs. 861, 862, and 863, and applicable regulations). Notwithstanding the omission of the standard provision, it is understood by the Treasury that the United States retains the right under the proposed treaty to apply its internal law intercompany pricing and expense allocation rules.

(13) The proposed treaty's limits on gross-basis dividend withholding taxes that the country of source may impose on dividends received by a resident of the other country differ from those of the U.S. model. Both treaties provide for two levels of limitation. With respect to the proposed treaty, these levels are 14 percent in the case of dividends paid to a 25-percent or more corporate owner, and 20 percent in other cases. These limitations contrast with the 5-percent limit on dividends paid to 10-percent or more corporate owners and the 15-percent limit on other dividends contained in the U.S. model.

Additionally, the proposed treaty sets forth special rules with respect to the application of the article on dividends to distributions by U.S. regulated investment companies (RICs) and real estate investment trusts (REITs). In the case of any dividends paid by an RIC to a corporation, a 20-percent gross basis withholding tax will apply, notwithstanding the level of ownership of the shareholder. In the case of dividends from an REIT, a 20-percent gross basis withholding tax rate applies if the recipient of the dividends is an

individual holding a less than 25-percent interest in the trust. In other cases, the rate of withholding tax applicable, under domestic law, to the underlying income of the REIT will apply (i.e., 30 percent).

(14) Generally, the proposed treaty, the U.S. model, and the OECD model all share a common definition of the term "dividends."² The proposed treaty further defines this term to include income from arrangements, including debt obligations, carrying the right to participate in profits, to the extent so characterized under the local law of the country in which the income arises.

(15) The proposed treaty generally allows imposition by one country of branch-level profits and interest taxes on corporations resident in the other country.

(16) The proposed treaty generally limits the rate of withholding tax at source on gross interest to 15 percent. As an exception to this general rule, interest is exempt from source-country taxation if it is derived by the governments of the countries, derived by financial institutions on certain long-term loans (i.e., obligations having maturities of seven years or more), or paid by the Tunisian Government to a U.S. resident in connection with loans extended to the Tunisian Government or its political subdivisions or local authorities. Under the U.S. model, all interest generally is exempt from source country withholding tax. The OECD model permits source-country taxation of interest at a rate of up to 10 percent.

As a result of the repeal, in the Tax Reform Act of 1984 (the "1984 Act"), of the U.S. gross withholding tax on interest paid on portfolio indebtedness held by foreign persons, Tunisian residents generally are able to earn U.S. source interest on portfolio indebtedness free of U.S. tax, without regard to benefits provided by a treaty. U.S. residents, on the other hand, generally are subject to Tunisian tax on Tunisian source interest on similar indebtedness (limited to a rate of 15 percent by the treaty).

(17) The proposed treaty allows source-country taxation of royalties at rates ranging from 10 to 15 percent. Both the U.S. and OECD models exempt royalties from source-country tax.

The proposed treaty includes in the definition of royalties, payments of any kind received in consideration for the use of, or the right to use, industrial, commercial, or scientific equipment. Such payments are not treated as royalties under the U.S. model, although they are so treated under the OECD model. Rather, they generally are subject, under the U.S. model, to the provisions of the business profits article of that treaty (Article 7).

(18) The proposed treaty permits source-country taxation of income derived from the performance of independent personal services by an individual resident of the other country on the basis of that individual's physical presence in the source country for more than 183 days during any taxable year. The proposed treaty also permits source-country taxation of income derived from the performance of independent personal services by such a person if the

² That definition is "income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident."

gross amount of such income for any taxable year exceeds \$7,500. Neither the U.S. model nor the OECD model allows taxation of such income on the basis of days of physical presence; nor do they allow such taxation on the ground that the amount of income derived exceeds a threshold level. Under the models, income derived from the performance of independent personal services by a non-resident is taxable in the source country only if that person earns the income through a fixed base in that country.

(19) Under the proposed treaty, a source country may tax income derived by an entertainer or athlete who is a resident of the other country from his or her activity as such if the amount of gross receipts from the source country exceeds \$7,500 in a taxable year. Under the U.S. model treaty, an entertainer or athlete is so taxable in the source country only if he or she earns more than \$20,000 there during a taxable year. Most U.S. income tax treaties follow the U.S. model rule, but adopt a lower annual income threshold. Under the OECD model, entertainers and athletes may be taxed by the source country without regard to the existence of a fixed base or other contacts with the source country, regardless of the amount of income that they earn from artistic or athletic endeavors.

(20) Under the U.S. model, the United States maintains the exclusive right to tax U.S. social security payments made to residents of the other country or to U.S. citizens. By contrast, the proposed treaty permits both the U.S. and Tunisia to tax social security payments. In cases where both countries tax such payments, the recipient's country of residence is required to provide relief from double taxation for any taxes imposed by the other country.

(21) The proposed treaty prohibits either country from taxing the recipient of child support payments. This result follows from U.S. law, which provides that such payments are not taxable to the recipient. The U.S. model allows only the country of residence of the payor to tax such payments.

(22) The proposed treaty generally permits a pension paid out of public funds of one of the countries to an individual who is a resident of the other country for past services rendered in the discharge of governmental functions to be taxed only by the individual's country of residence. If the individual is a citizen of the paying country, however, that country may also tax the payments. This provision represents a departure from the U.S. model provision that permits the paying country to tax any such payment made to a resident of the other country.

(23) The exemption from host country taxation provided in the proposed treaty to visiting students and trainees differs from the corresponding exemptions provided in the U.S. model. The model exemptions apply only to payments received from outside the host country for maintenance, education, study, research, or training. The proposed treaty exemption extends to, among other things, \$4,000 per year of personal services income in the case of a student. The proposed treaty limits the period during which the exemption applies to five years, whereas the U.S. model does not set forth any time limit for this purpose.

(24) Both the proposed treaty and the U.S. model contain provisions that prohibit a country (the "taxing country") from subjecting

certain persons to any taxation or related requirement that is more burdensome than the taxation and related requirements to which its nationals are subjected. For purposes of the U.S. model, this provision applies to any national of the other country. By contrast, application of the corresponding rule in the proposed treaty is limited to nationals of the other country who are resident in the taxing country.

(25) The anti-treaty shopping provisions of the proposed treaty resemble, to some extent, those of the U.S. model. Certain differences exist between the two provisions, however. For example, the U.S. model requires more than 75 percent of the beneficial interest of a non-public company that is resident in one of the countries to be owned by individual residents of that country in order to qualify for treaty benefits. The proposed treaty reduces the ownership threshold to 50 percent. Furthermore, those who must own the threshold percentage include not only individual residents of the country in which the company is resident, but also individual residents of the other country, U.S. citizens, and the governments of the two countries. Similar 50-percent thresholds are also contained in the anti-treaty shopping provisions of Code section 884(e)(4) (relating to the branch-level profits and interest taxes), as well as in other recent treaties.

The U.S. model contains two special rules related to treaty shopping, neither of which is included in the proposed treaty. Under the first special rule, the general rules limiting treaty benefits do not apply if it is determined that the principal purpose behind the acquisition or maintenance of an entity and the conduct of its operations was not to obtain treaty benefits. Under the second special rule, the U.S. model specifies that no treaty relief is granted by one country to a resident of the other country if, under the domestic law of that other country, the income to which the relief relates bears significantly lower tax than similar income arising in the other country derived by residents of the other country.

Under the proposed treaty, a country is required to consult with the competent authority of the other country prior to denying treaty benefits to a resident of the other country. As described by the Treasury in its Technical Explanation, the Committee understands that this rule does not impose a requirement that there be an agreement between the two competent authorities before benefits can be denied. Rather, this rule is designed to facilitate notification of such a denial by one of the competent authorities to the other. Furthermore, a special rule contained in the proposed treaty permits a person to whom treaty benefits are denied under the general rules to nevertheless be granted those benefits if so determined by the competent authority of the country in which the relevant income arises.

(26) The U.S. model provides for the exchange of information relating to taxes of every kind imposed by the two countries. By contrast, the proposed treaty provides for the exchange of information only as it is relevant to the assessment of taxes covered by the treaty. The U.S. model requires that, upon an appropriate request for information, the requested country provide the information in the form requested. Although the proposed treaty requires a requested competent authority to obtain the information so request-

ed, there is no requirement that the information be obtained and transmitted in any specific manner or form. Also unlike the U.S. model treaty (but like the OECD model), the proposed treaty does not obligate either country to endeavor to collect, on behalf of the other country, such amounts as may be necessary to ensure that relief granted by the treaty from tax imposed by the other country does not inure to the benefit of persons not entitled thereto.

IV. DATE OF ENTRY INTO FORCE AND TERMINATION

ENTRY INTO FORCE

The proposed treaty will enter into force upon the exchange of the instruments of ratification. It takes effect with respect to taxes withheld at source for amounts paid or credited on or after the earlier of the first day of January following the exchange of instruments of ratification or the first day of the fourth month following the exchange of instruments of ratification. With respect to other taxes, the proposed treaty takes effect for taxable years ending on or after December 31st of the year during which the exchange of instruments of ratification takes place.

TERMINATION

The proposed treaty is to remain in force indefinitely, but either country may terminate it at any time after five years from its entry into force by giving at least six months' notice, through diplomatic channels, prior to the end of any calendar year. If a termination occurs, it is effective with respect to income of calendar or taxable years beginning (or, in the case of taxes payable at the source, payments made) on or after the January 1st next following the expiration of the six-month period.

V. COMMITTEE ACTION

The Committee on Foreign Relations held a public hearing on the proposed Tunisian income tax treaty and protocol, and on other proposed treaties, on June 14, 1990, chaired by Senator Sarbanes. The Committee considered the proposed treaty and protocol on June 28, 1990, and ordered them favorably reported by a voice vote with certain understandings, with the recommendation that the Senate give its advice and consent to ratification of the proposed treaty and protocol.

VI. COMMITTEE COMMENTS

The Committee on Foreign Relations approved the proposed treaty and protocol. On balance, the Committee believes that this treaty is in the interest of the United States and urges that the Senate act promptly to give advice and consent to ratification. However, the Committee has taken note of certain issues raised by the proposed treaty, and believes that the following comments may be useful to U.S. Treasury officials in providing guidance on these matters should they arise the course of future treaty negotiations.

(1) U.S. TAX ON CERTAIN STOCK GAINS OF FOREIGN PERSONS

The United States does not currently impose tax on U.S. source noneffectively connected capital gains of nonresident alien individuals and foreign corporations, with primarily two exceptions: (1) gains realized by a nonresident alien individual who is present in the United States for at least 183 days during the taxable year, and (2) certain gains from the sale of interests in U.S. real estate. The proposed treaty provides that gains of Tunisian residents are exempt from U.S. tax unless they are (1) gains from the disposition of U.S. real property interests; (2) gains from the alienation of personal property which forms or formed part of the business property of a permanent establishment or a fixed base in the United States; or (3) gains from the alienation of a right or property which are contingent on the productivity, use, or disposition thereof. Thus, if a Tunisian resident, without a U.S. permanent establishment or fixed base, owns stock in a U.S. corporation, any gains from the disposition of that stock generally will be exempt from U.S. tax under the treaty, whether or not U.S. internal law is changed to provide for such a tax, unless that change is intended to override existing treaties.

In 1989 the House of Representatives passed a bill that would have taxed the gain on a disposition by a foreign person of stock in a U.S. corporation if the foreign person holds or held more than 10 percent of the stock of the U.S. corporation at any time during the 5 years prior to the disposition.³ This provision, had it been enacted into law, would have yielded to contrary existing treaties for a 3-year period and then overridden them subsequently. In the committee report on this provision, however, it was anticipated that in some cases, it could have been desirable for the United States to enter into treaties that would modify the effect of the provision on treaty country residents.

The override provision was considered by the Administration to be a serious defect in the bill, putting aside the more basic tax policy question whether such gains of foreign persons should be exempt in all cases from U.S. tax, when dividends paid by U.S. corporations to foreign persons are not, or whether or not it would be more appropriate to tax gains no more favorably than dividends.

Bills have been introduced this year in both Houses of Congress that would tax as effectively connected income gains derived by foreign persons from the sale of stock of domestic corporations in cases where the foreign person holds or held at least 10 percent of the stock of the domestic corporation.⁴ Unlike the unsuccessful House bill provision of 1989, the 1990 bills generally do not override existing contrary treaties. The proposed treaty would thus prevent the operation of the bill vis-a-vis Tunisian residents if the bill is passed.

As a general matter, the Committee is concerned about recommending consent to ratification of a treaty that forbids a tax that the Congress may decide to impose as the result of a change in its internal tax law policy. Although prior Congresses may have be-

³ H.R. 3299, sec. 11404, 101st Cong., 1st Sess. (1989). The provision was deleted in conference.

⁴ H.R. 4308, sec. 201, 101st Cong., 2d Sess. (1990); S. 2410, sec. 201, 101st Cong., 2d Sess. (1990).

lieved that the gains realized by foreign persons from the disposition of stock in U.S. companies were properly excluded, as a statutory matter, from the U.S. tax base, whether for reasons of administrability or for other reasons, Congress may decide that it is no longer appropriate to do so in the case of substantial foreign shareholders in U.S. companies. The Congress could further decide that, just as it is inappropriate in treaties to reduce source-country taxation of dividends to zero, it is similarly inappropriate to reduce to zero the rate of tax on gains from stock that pays such dividends, or that it is inappropriate to reduce such tax to zero in all cases and for all types of dispositions.

Alternatively, the Congress could decide that, while a tax on stock gains should be imposed by statute, it may properly be waived in treaties, or at least treaties with countries that, in Congress's view, impose an adequate level of tax on the types of stock gains of its residents that would otherwise be subject to tax under the statute. As reflected in the OECD model and many existing treaties, for example, countries that do impose tax on the stock gains of foreign persons often waive such taxes in treaties, although because of differences in definitions of the term "gains" in other countries, those treaties may not operate in precisely the same manner as a U.S. income tax treaty, using U.S. definitions of the term "gain," would operate. (The U.S. model treaty also provides for waiver of the tax, but the U.S. model was last revised at a time when such a waiver would not have reduced any U.S. tax otherwise imposed by the Code, and thus could only have reduced foreign country taxes.)

The Committee understands that Tunisia does not currently impose a tax on stock gains of foreign persons. Thus, prohibition of that tax in the proposed treaty may not be viewed as a benefit to U.S. taxpayers (or the U.S. fisc) at the expense of the Tunisian fisc. However, if both countries were to at some point in the future impose such a tax, then some may argue that such a prohibition would most likely represent a benefit to U.S. taxpayers (or the U.S. fisc), in light of the balance of investment flows between the two countries. If the Senate agrees to a treaty with Tunisia, and then Congress enacts the stock gains tax that the treaty protects Tunisian residents from paying, it is unclear whether, in subsequent treaty negotiations, the United States and Tunisia would agree to retention or removal of the treaty restriction on each country's tax on stock gains of foreign persons. Consideration might be given, by both parties to the treaty, to questions such as whether Tunisia at that time imposed a similar tax under its internal law and how the imposition or elimination of such a tax by the United States (and by Tunisia, if applicable) is likely to affect the taxation by Tunisia of U.S. residents, as well as the taxation by the United States of Tunisian residents.

The Committee does not believe that its general concern about entering into treaties in conflict with pending tax policy changes necessitates a reservation of this treaty. It is not clear if or when Congress will enact a tax on foreign persons' stock gains; if Congress does not do so, then there will have been no need to take action on this issue. In addition, the Congress might conclude that

the waiver contained in the proposed treaty is in the best interests of the United States.

(2) DEVELOPING COUNTRY CONCESSIONS

The proposed treaty contains a number of developing country concessions, some of which are found in other U.S. income tax treaties with developing countries. Some of these concessions are listed below.

Definition of permanent establishment

The proposed treaty departs from the U.S. and OECD model treaties by providing for relatively broad source-basis taxation. The proposed treaty's permanent establishment article, for example, permits the country in which business activities are carried on by a resident of the other country to tax the activities sooner, in certain cases, than it would be able to under either of the model treaties. Under the proposed treaty, a building site or construction, assembly, or installation project (or supervisory activities related to such projects) creates a permanent establishment if it exists in a country for more than 183 days in any 365-day period; under the U.S. model, a building site, etc., must last for at least one year before a permanent establishment is created. Thus, for example, under the proposed treaty, business profits attributable to an installation project in Tunisia are taxable by Tunisia if the project lasts for more than 183 days during a 365-day period. Similarly, under the proposed treaty, the use of a drilling rig in Tunisia for more than 183 days during a 365-day period creates a permanent establishment there; under the U.S. model, drilling rigs must be present in a country for at least one year to have the same effect. The 183-day period set forth in the proposed treaty is also utilized in tax treaties between the United States and other developing countries.

In addition, the proposed treaty contains a special provision that treats an insurance company that is resident in one of the countries as having a permanent establishment in the other country in certain cases if it receives premiums from, or insures risks in, that other country. This rule applies unless the risks are insured through a broker or independent agent operating in the ordinary course of his or her business. Under this rule, for example, if a U.S. insurance company, through an employee, insures risks located in Tunisia, then the income generated from the insurance of those risks may be taxed by Tunisia under the business profits article of the proposed treaty. A similar provision is found in the United Nations' model treaty.

Source-basis taxation

Concessions to source-basis taxation in the proposed treaty include maximum rates of source-country tax on interest (15 percent, subject to certain exceptions providing for complete exemption), dividends (14 percent for direct investors, 20 percent for other shareholders), and royalties (either 10 or 15 percent depending on the nature of the royalty) that are higher than those provided in the U.S. model treaty, but which, in some cases, represent reductions from the tax that would be imposed by Tunisia on these types

of income absent a treaty. Also, the proposed treaty provides for broader source-country taxation of independent personal services income and entertainers' income than is allowed by the U.S. model.

Certain equipment leasing

In addition to containing the traditional definition of royalties which is found in most U.S. tax treaties (including the U.S. model), the proposed treaty provides that royalties include payments for the use of, or the right to use, industrial, commercial, or scientific equipment. These payments are often considered rentals in treaties with other industrialized countries, subject to business profits rules which generally permit the source country to tax such profits only if they are attributable to a permanent establishment located in that country. In such case, the tax is computed on a net basis. By contrast, the proposed treaty permits gross-basis source-country taxation of these payments, at a rate not to exceed 10 percent, if the payments are not attributable to a permanent establishment situated in that country.⁵

Taxation of public pensions

Under the U.S. and OECD model treaties, pensions paid to persons out of the public funds of a treaty country (or of its political subdivisions or local authorities) with respect to services rendered in the discharge of functions of a governmental nature may be taxed by that country. Thus, for example, if the Government of the United States were to make pension payments to a resident of the other treaty country, those payments could be taxed by the United States. By contrast, the proposed treaty prohibits the paying country from taxing similar payments made to residents of the other country, unless the recipient of the payments is a citizen of the paying country. Therefore, in a situation similar to that described above, the United States would be precluded by the proposed treaty from taxing governmental pension payments made to a resident of Tunisia, unless that person was a U.S. citizen.

Conclusion of the Committee

The Committee is concerned that such provisions not be viewed as the starting point for future negotiations with developing countries. It must be clearly recognized that several of the rules of the proposed treaty represent substantial concessions by the United States, and that such concessions must be met (as they are in this case) with substantial concessions by the treaty partner. Thus, future negotiations with developing countries should not assume, for example, that the definition of a permanent establishment provided in this treaty will necessarily be available in every case; rather, such a definition will only be adopted in the context of an agreement that satisfactorily addresses the concerns of the United States.

⁵ If the payments are attributable to such a permanent establishment, then the business profits article of the proposed treaty applies.

(3) TREATY SHOPPING

The proposed treaty, like a number of U.S. income tax treaties, generally limits treaty benefits for treaty country residents so that only those residents with a sufficient nexus to a treaty country will receive treaty benefits. Although the proposed treaty is intended to benefit residents of Tunisia and the United States only, residents of third countries sometimes attempt to use a treaty to obtain treaty benefits. This is known as treaty shopping. Investors from countries that do not have tax treaties with the United States, or from countries that have not agreed in their tax treaties with the United States to limit source-country taxation to the same extent that it is limited in another treaty may, for example, attempt to secure a lower rate of tax on interest by lending money to a U.S. person indirectly through a country whose treaty with the United States provides for a lower rate. The third-country investor may do this by establishing a subsidiary, trust, or other investing entity in that treaty country, which then makes the loan to the U.S. person and claims the treaty reduction for the interest it receives.

The anti-treaty shopping provision of the proposed treaty is similar to an anti-treaty shopping provision in the Internal Revenue Code (as interpreted by Treasury regulations) and in several newer treaties. Some aspects of the provision, however, differ either from the anti-treaty shopping provision of the U.S. model or from the anti-treaty shopping provisions sought by the United States in some treaty negotiations since the model was published in 1981. The issue is whether the proposed treaty's anti-treaty shopping provision effectively forestalls potential treaty shopping abuses.

One provision of the anti-treaty shopping article of the proposed treaty is more lenient than the comparable rule in the U.S. model and other U.S. treaties. The U.S. model allows benefits to be denied if 75 percent or less of a resident company's stock is held by individual residents of the company's country of residence, while the proposed treaty (like several recent treaties and an anti-treaty shopping provision in the Code) lowers the qualifying percentage to 50, and broadens the class of qualifying shareholders to include residents of either treaty country, citizens of the United States, and the governments of the two treaty countries. Thus, this safe harbor is considerably easier to enter, under the proposed treaty. On the other hand, counting for this purpose shareholders who are residents of either treaty country would not appear to invite the type of abuse at which the provision is aimed; that is, ownership by third-country residents attempting to obtain unwarranted treaty benefits. In addition, a base erosion test contained in the proposed treaty provides protection from many potential abuses of a Tunisian conduit.

Another provision of the anti-treaty shopping article differs from the comparable rule of the U.S. model, but the effect of the change is less clear. The general test applied by the U.S. model to allow benefits, short of meeting the bright-line ownership and base erosion test, is a broadly subjective one, looking to whether the acquisition, maintenance, or operation of an entity did not have "as a principal purpose obtaining benefits under" the treaty. By contrast, the proposed treaty contains a more precise test that allows denial

of benefits only with respect to income not derived in connection with (or incidental to) the active conduct of a trade or business. (However, this active trade or business test generally does not apply with respect to a business of making or managing investments, so benefits can be denied with respect to such a business regardless of how actively it is conducted.) In addition, the proposed treaty gives the competent authorities the ability to override this standard.

The practical difference between the proposed treaty tests and the U.S. model test will depend upon how they are interpreted and applied. The principal purpose test may be applied leniently (so that any colorable business purpose suffices to preserve treaty benefits), or it may be applied strictly (so that any significant intent to obtain treaty benefits suffices to deny them). Similarly, the standards in the proposed treaty could be interpreted to require, for example, a more active or a less active trade or business (though the range of interpretation is far narrower). Thus, a narrow reading of the principal purpose test could theoretically be stricter than a broad reading of the proposed treaty test (i.e., would operate to deny benefits in potentially abusive situations more often).

The Committee believes that the United States should maintain its policy of limiting treaty shopping opportunities whenever possible, and in exercising any latitude Treasury has to adjust the operation of the proposed treaty, the Committee is particularly concerned that the rules as applied adequately deter treaty shopping abuses. The anti-treaty shopping provision contained in the proposed treaty may be effective in preventing third-country investors from obtaining treaty benefits by establishing investing entities in Tunisia since those investors may be unwilling to share ownership of such investing entities on an equal basis with U.S. or Tunisian residents in order to meet the ownership test of the anti-treaty shopping provision. On the other hand, the Committee is aware that implementation of the tests for treaty shopping set forth in the treaty may raise factual, administrative, or other issues that cannot currently be foreseen. The Committee emphasizes that the new rules must be implemented so as to serve as an adequate tool for preventing possible treaty-shopping abuses in the future.

(4) EXCHANGE OF INFORMATION

The exchange of information article contained in the proposed treaty differs, in some respects, from the corresponding articles of the OECD and U.S. model treaties. The exchange of information article of the U.S. model, as compared to that article in the OECD model (and in the proposed treaty) provides for a somewhat broader scope of information exchange. For example, although the U.S. model and the proposed treaty contain a provision not found in the OECD model, that places a requirement on the competent authority of a treaty country to obtain the information requested by the other competent authority "in the same manner and to the same extent" as if the tax of the requesting country was its own tax and was being imposed by it, the U.S. model provision goes further than do the proposed treaty or the OECD model by providing an additional information-exchange requirement. The provision of the

U.S. model places a requirement on each treaty country, if specifically requested by the other country, to provide information in the form of depositions of witnesses and authenticated copies of unedited original documents, including books, papers, statements, records, accounts, or writings, to the same extent that such depositions and documents are obtainable under its internal laws and administrative practices and procedures with respect to its own taxes. This part of the U.S. model's exchange of information article is intended to assure that evidence can be obtained in a form admissible for purposes of litigation.

A second difference between the U.S. model and the proposed treaty (and OECD model) is that the U.S. model contains a clause that requires each treaty country to assist in the collection of taxes to the extent necessary to ensure that treaty benefits provided by the other country are enjoyed only by persons entitled to those benefits under the treaty. In providing such assistance, the U.S. model does not impose on the other country an obligation to carry out administrative measures that are at variance with its internal measures for tax collection, or that are contrary to its sovereignty, security, or public policy. Assistance in collection can be useful, for example, in a case where an entity located in a country with which the United States has a treaty serves as a nominee for a third-country resident. If the entity, on behalf of the third-country resident, receives a dividend from a U.S. corporation with respect to which a reduced rate of tax (as provided for by the treaty) is inappropriately withheld, the entity, as a withholding agent, is technically liable to the United States for the underpaid amount of tax. However, without assistance from the government of the treaty country in which the entity is resident, enforcement of that liability may be difficult.

A third item which causes the U.S. model's exchange of information provisions to be more expansive than the corresponding provisions of the other two treaties is that the model's provisions are made specifically applicable to taxes of every kind imposed at the national level, notwithstanding the limitations contained in the taxes covered article of the treaty. A provision of this type permits, for example, information exchanges regarding estate taxes even though general application of the treaty provision do not cover those taxes.

Although the Committee believes that it would be preferable for the United States to be able to obtain information from Tunisia in the forms specified in the U.S. model treaty and to utilize the Tunisian Government for tax collection assistance purposes, the absence of these provisions in the proposed treaty does not, in the Committee's opinion, warrant a reservation of the proposed treaty. Because the proposed treaty does require Tunisia to obtain information requested by the United States in the same manner and to the same extent as if the U.S. tax at issue were Tunisian tax, some assurance is provided that Tunisia will take whatever measures are possible under its tax laws to obtain information for the benefit of the United States.

VII. BUDGET IMPACT

The Committee has been informed by the staff of the Joint Committee on Taxation that the proposed treaty is estimated to have a minimal negative effect on annual budget receipts.

VIII. EXPLANATION OF TREATY PROVISIONS

Set forth below is a detailed, article-by-article explanation of the proposed income tax treaty and, where applicable, the proposed protocol between the United States and Tunisia.

ARTICLE 1. PERSONAL SCOPE

As a general rule, the proposed treaty applies to residents of the United States or Tunisia or of both countries. For purposes of the proposed treaty, the definition of a resident of the United States or Tunisia is set forth in the article on fiscal domicile (Article 4). There are certain exceptions to the general application of the proposed treaty to residents of the United States or Tunisia. For example, the article dealing with general rules of taxation (Article 22) provides, among other things, that either country reserves the right to tax its citizens (and in certain cases former citizens) or residents in accordance with its domestic laws as if the proposed treaty was not in effect. In addition, other provisions of the proposed treaty, such as provisions related to exchange of information and administrative assistance (Article 26) and the source rule for interest payments (Article 11(6)), may apply to persons not specified in Article 1.

ARTICLE 2. TAXES COVERED

In the case of the United States, the proposed treaty applies to the Federal income taxes imposed under the Code. It does not apply, however, to the accumulated earnings tax, the personal holding company tax, or social security taxes. In addition, the proposed treaty generally does not apply to non-income taxes such as excise,⁶ unemployment, estate, or gift taxes. Likewise, state and local taxes generally are not covered by the proposed treaty.

In the case of Tunisia, the treaty applies to the following taxes: the tax on industrial and commercial profits; the tax on corporations; the tax on capital gains on real property; the tax on profits of non-commercial professions; the tax on wages, salaries, and pensions; the agricultural tax; the tax on dividends; the tax on income from credits, deposits, guarantees and current accounts; the personal income tax; and the extraordinary tax for national solidarity.

The proposed treaty contains a provision generally found in U.S. income tax treaties to the effect that it also will apply to any identical or substantially similar taxes that either country may subsequently impose.

⁶ The excise tax imposed on insurance premiums paid to foreign insurers is not covered under the proposed treaty, although this is a covered tax under the U.S. model treaty, as well as under some recent U.S. income tax treaties. The preferred U.S. treaty position for some countries does not include coverage of this excise tax.

Additionally, the non-discrimination provisions of the proposed treaty (Article 24) apply to all taxes of every kind imposed at the national, state, or local level by the United States or Tunisia.

ARTICLE 3. GENERAL DEFINITIONS

The proposed treaty contains some of the standard definitions found in most U.S. income tax treaties.

The term "person" is defined to include an individual, a company, an estate, a trust, or any other body of persons. As explained in the Treasury Department's Technical Explanation of the proposed treaty, a partnership is included in this definition under the phrase "any other body of persons."

The term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting States" mean, respectively, an enterprise carried on by a resident of one of the treaty countries and an enterprise carried on by a resident of the other treaty country.

The U.S. competent authority is the Secretary of the Treasury or his delegate. The U.S. competent authority function has been delegated to the Commissioner of Internal Revenue, who has redelegated the authority to the Assistant Commissioner (International) of the IRS. On interpretive issues, the latter acts with the concurrence of the Associate Chief Counsel (International) of the IRS.

The Tunisian competent authority is the Minister of Finance, or his representative.

For purposes of the proposed treaty, the "United States" means the United States of America. When used in a geographical sense, the term includes the fifty States, the District of Columbia, and the area adjacent to the U.S. territorial sea over which, in accordance with international law, the United States may exercise rights with respect to the natural resources of the seabed and marine subsoil. The definition is intended to cover the U.S. continental shelf consistent with the definition of continental shelf contained in section 638 of the Code. The Committee understands, as explained in the Technical Explanation, that the term "United States" does not include Puerto Rico, the Virgin Islands, Guam or any other U.S. possession or territory.

The term "Tunisia" means the Republic of Tunisia. When used in a geographical sense, the term includes the territory of the Republic of Tunisia and the area adjacent to the Tunisia territorial sea over which, in accordance with international law, Tunisia may exercise rights with respect to the natural resources of the seabed and marine subsoil.

The proposed treaty defines "international traffic" as any transport by a ship or aircraft, except where the transport is solely between places in the other treaty country. Accordingly, with respect to a Tunisian enterprise, purely domestic transport in the United States is excluded from this definition.

The proposed treaty provides that any term which it does not define is to have the meaning it has under the applicable law of the country applying the proposed treaty, unless the context otherwise requires. According to the Technical Explanation, if the mean-

ing of an undefined term under one country's law is different from its meaning under the other country's law, or is not readily determinable under either country's law, the competent authorities of the two countries may establish a common meaning for the undefined term.

ARTICLE 4. FISCAL DOMICILE

The assignment of a country of residence is important because the benefits of the proposed treaty generally are available only to a "resident" of one of the countries as that term is defined by the proposed treaty. Furthermore, double taxation is often avoided by the proposed treaty assigning one of the countries as the country of residence where, under the laws of the countries, a person is a resident of both.

Under U.S. law, residence of an individual is important because a resident alien is taxed on his or her worldwide income, whereas a nonresident alien is taxed only on U.S. source income and on income that is effectively connected with a U.S. trade or business. A company is a resident of the United States if it is organized in the United States. Under the standards for determining residence provided under U.S. law, an individual who spends substantial time in the United States in any year or over a three-year period generally is a U.S. resident. A permanent resident for immigration purposes also is a U.S. resident. The standards for determining residence provided under U.S. law do not alone determine the residence of a U.S. citizen for the purpose of any U.S. tax treaty (such as a treaty that benefits residents, rather than citizens, of the United States).

Under the proposed treaty, the term "resident of a Contracting State" means the United States and Tunisia (or any political subdivision or local authority of either), and any person who under the laws of either the United States or Tunisia is subject to tax in that country by reason of his or her domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature. The Committee understands that, as reflected in the Technical Explanation, a partnership is considered a resident of either country only to the extent that the income it derives is subject to tax as the income of a resident of the country. For example, if the share of Tunisian partners in the income of a partnership is only one-half, the United States would have to reduce its withholding tax on only one-half of the U.S. source income paid to the partnership.

Under this article of the proposed treaty, U.S. citizenship alone does not establish U.S. residency for treaty purposes. As a result, U.S. citizens residing overseas (in countries other than Tunisia) generally are not entitled to the benefits of the proposed treaty as U.S. residents. Only in very few U.S. income tax treaties has the United States negotiated coverage for nonresident U.S. citizens. The proposed treaty provides that Tunisia must treat a U.S. citizen or alien admitted to the United States for permanent residence (i.e., a U.S. "green card" holder) as a U.S. resident only if the individual has a substantial presence, permanent home, or habitual abode in the United States.

The fiscal domicile article also provides a set of "tie-breaker" rules to determine residence in the case of an individual who, under the basic residence rules, is considered a resident of both the United States and Tunisia. These rules are similar to those contained in the U.S. model treaty. Such a dual resident individual will be deemed to be a resident of the country in which he has a permanent home available to him. If this permanent home test is inconclusive because the individual has a permanent home in both countries, the individual's residence is deemed to be the country with which his personal and economic relations are closer, i.e., his "center of vital interests." If the country in which he has his center of vital interests cannot be determined, or if he does not have a permanent home available to him in either country, he shall be deemed to be a resident of the country in which he has an habitual abode. If the individual has an habitual abode in both countries or in neither of them, he shall be deemed to be a resident of the country of which he is a national. If he is a national of both countries or neither of them, the competent authorities of the countries are to settle the question of residence by mutual agreement.

In the case of a dual resident person other than an individual, the proposed treaty requires the competent authorities of the two countries to endeavor to settle the question by mutual agreement and to determine how the proposed treaty applies to that person. Dual residency may occur, for example, in the case of a corporation as a result of the differing standards for determining residency under the domestic laws of the United States and Tunisia. Under U.S. law, a corporation is considered a resident of the United States if it is organized or incorporated under the laws of the United States or of any State. By contrast, Tunisia treats any corporation, wherever organized or incorporated, as a resident of Tunisia if its place of effective management is in Tunisia. The Committee understands, based on information provided by the Treasury Department, that the U.S. competent authority has never agreed to treat a U.S.-incorporated company as a nonresident of the United States for treaty purposes, and as a matter of policy never would so agree.

ARTICLE 5. PERMANENT ESTABLISHMENT

The proposed treaty contains a definition of the term "permanent establishment" that, subject to certain modifications, generally follows the pattern of other recent U.S. income tax treaties, the U.S. model treaty, and the OECD model treaty.

The permanent establishment concept is one of the basic devices used in income tax treaties to limit the taxing jurisdiction of the host country and thus mitigate double taxation. Generally, a resident of one country is not taxable by the other country on its business profits unless those profits are attributable to a permanent establishment of the resident in that other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties apply, or whether those amounts are taxed as business profits.

In general terms, under the proposed treaty, a permanent establishment is a fixed place of business through which a resident of one country engages in business in the other country. A permanent establishment includes (but is not limited to) a place of management, branch, office, factory, workshop, or a mine, oil or gas well, quarry, or other place of extraction of natural resources. A permanent establishment also includes a building site, construction, assembly, or installation project, or an installation, drilling rig, or ship used for the exploration or development of natural resources, or related supervisory activities, but only if the site, project, or activity lasts for more than 183 days in any 365-day period. This 183-day rule differs from the 12-month rule of the U.S. model.

The general permanent establishment rule is modified to provide that a fixed place of business in one country which is only used by a resident of the other country for any or all of a number of specified activities does not constitute a permanent establishment. These activities include the use of facilities solely for storing, displaying, or delivering goods or merchandise belonging to the enterprise; the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, delivery, or processing by another enterprise; and the maintenance of a fixed place of business solely to purchase goods or merchandise, to collect information, or to carry on any other activity of a preparatory or auxiliary character (the Committee understands that these could include, for example, advertising, supplying information, or scientific research), for the enterprise. In addition, the maintenance of a fixed place of business solely for any combination of the activities listed in this paragraph does not constitute a permanent establishment as long as the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

If a resident of one country maintains an agent in the other country who has, and habitually exercises, the authority to conclude contracts in that other country in the name of the resident, then the resident generally is deemed to have a permanent establishment in that other country. This rule does not apply where the contracting authority is limited to those activities, such as storage, display, or delivery of merchandise (as described in the preceding paragraph) that are excluded from the definition of permanent establishment. The proposed treaty contains the usual provision that the agency rule does not apply if the agent is a broker, general commission agent, or other agent of independent status acting in the ordinary course of his or her business.

The fact that a company which is a resident of one country controls, or is controlled by, a company which is a resident of the other country or which is engaged in business in that other country (whether through a permanent establishment or otherwise) does not in and of itself constitute either company a permanent establishment of the other.

The proposed treaty provides a special rule for the determination of the existence of a permanent establishment in the case of companies engaged in insurance activities. Generally, if an insurance company that is a resident of one of the countries earns premiums from, or insures risks in, the other country, then it is considered to

have a permanent establishment in that other country. This rule does not apply, however, if the insurance is placed through a broker or agent of independent status acting in the ordinary course of his or her business.

ARTICLE 6. INCOME FROM REAL PROPERTY

The proposed treaty provides that income from real property, including income from the leasing or use in any form of real property and income from agriculture or forestry, may be taxed by the country in which the real property or natural resources are situated. Additional rules regarding the taxation of dispositions of real property are provided in the article on capital gains (Article 13).

The term "real property" has the meaning which it has under the law of the country in which the property in question is located. The term in any case includes property accessory to real property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property, and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. Ships, boats, and aircraft are not real property.

Although an election to compute tax on income from real property on a net basis is often included in U.S. tax treaties (and is included in the U.S. model treaty), no such election is provided for in the proposed treaty. Though the proposed treaty does not contain this election, such treatment is provided for U.S. real property income under the Code (secs. 871(d) and 882(d)). The Committee understands that a form of net basis taxation of Tunisian real property income is also provided under Tunisian domestic law.

Real property income may also be taxed by the taxpayer's country of residence. In such a case, residence-country taxation is subject to relief from double taxation (Article 23).

ARTICLE 7. BUSINESS PROFITS

United States Code rules

U.S. law distinguishes between the business income and the investment income of a nonresident alien or foreign corporation. A nonresident alien or foreign corporation is subject to a flat 30-percent rate (or lower treaty rate) of tax on certain U.S. source income if that income is not effectively connected with the conduct of a trade or business within the United States. The regular individual or corporate tax rates apply to income (from any source) that is effectively connected with the conduct of a trade or business within the United States.

The taxation of income as business or investment income varies depending upon whether the income is U.S. or foreign. In general, U.S. source periodic income (such as interest, dividends, rents, and wages), and U.S. source capital gains are effectively connected with the conduct of a trade or business within the United States only if the asset generating the income is used in or held for use in the conduct of the trade or business, or if the activities of the trade or business were a material factor in the realization of the income. All other U.S. source income of a person engaged in a trade or

business in the United States is treated as effectively connected with the conduct of a trade or business in the United States (thus, it is said to be taxed as if it were business income under a limited "force of attraction" rule).

In the case of foreign persons other than insurance companies, foreign source income is effectively connected income only if the foreign person has an office or other fixed place of business in the United States and the income is attributable to that place of business. For such persons, only three types of foreign source income can be effectively connected income: rents and royalties on intangible property derived from the active conduct of a licensing business; dividends and interest, derived in the active conduct of a banking, financing, or similar business in the United States, (or received by a corporation the principal business of which is trading in stocks or securities for its own account); and certain sales income attributable to a U.S. sales office.

The foreign source income of a foreign corporation that is subject to tax under the insurance company provisions of the Code may be treated as U.S.-effectively connected without regard to the foregoing rules, so long as such income is attributable to the U.S. business of the foreign corporation. In addition, the net investment income of such a company which must be treated as effectively connected with the conduct of an insurance business within the United States is not less than an amount based on a combination of asset/liability ratios and rates of return on investments experienced by the foreign person in its worldwide operations and by the U.S. insurance industry.

Trading in stocks, securities, or commodities in the United States for one's own account generally does not constitute a trade or business in the United States, and accordingly, income from those activities is not taxed by the United States as business income. Thus, income from trading through a U.S.-based employee, a resident broker, commission agent, custodian, or other agent, or from trading by a foreign person physically present in the United States generally is not taxed as business income. However, this rule does not apply to a dealer or to a corporation the principal business of which is trading in stocks or securities for its own account.

The Code, as amended by the 1986 Act, provides that any income or gain of a foreign person for any taxable year that is attributable to a transaction in any other taxable year will be treated as effectively connected with the conduct of a U.S. trade or business if it would have been so treated had it been taken into account in that other taxable year (Code sec. 864(c)(6)). In addition, the Code provides that if any property ceases to be used or held for use in connection with the conduct of a trade or business within the United States, the determination of whether any income or gain attributable to a sale or exchange of that property occurring within 10 years after the cessation of business is effectively connected with the conduct of trade or business within the United States shall be made as if the sale or exchange occurred immediately before the cessation of business (Code sec. 864(c)(7)).

Proposed treaty rules

Under the proposed treaty, business profits of an enterprise of one country are taxable in the other country (the "source country") only if the enterprise carries on business through a permanent establishment situated in the other country, and only to the extent that the profits are attributable to that permanent establishment. This is one of the basic limitations on a source country's right to tax income of a resident of the other country.

Article III of the proposed protocol contains a provision that is relevant to the rules contained in this article, as well as in the articles on dividends (Article 10), interest (Article 11), royalties (Article 12), capital gains (Article 13), independent personal services (Article 14), and other income (Article 21). That provision, which is consistent with Code section 864(c)(6), states that for the implementation of those articles, profits and income attributable to a permanent establishment or fixed base during its existence are taxable in the country in which the permanent establishment or fixed base is located, even if the payments of such profits and income are deferred until the permanent establishment or fixed base has ceased to exist.

The taxation of business profits under the proposed treaty differs from the U.S. rules for taxing business profits primarily by requiring more than merely being engaged in a trade or business before a country can tax business profits, and by substituting an "attributable to" standard for the Code's "effectively connected" standard. Under the Code, all that is necessary for effectively connected business profits to be taxed is that a trade or business be carried on in the United States. Under the proposed treaty, on the other hand, some level of fixed place of business must be present and the business profits must be attributable to that fixed place of business.

The business profits of a permanent establishment are determined on an arm's-length basis. Thus, there is attributed to a permanent establishment the business profits which might be expected to have been derived by it if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment, or with any other associated enterprise. For example, this arm's-length rule applies to transactions between a permanent establishment and a branch of the resident enterprise located in a third country. Amounts may be attributed whether they are from sources within or without the country in which the permanent establishment is located.

In computing taxable business profits, deductions generally are allowed under paragraph 3 of Article 7 for expenses, wherever incurred, that are incurred for the purposes of the business of the permanent establishment. These deductions include executive and general administrative expenses. Thus, for example, a U.S. company that has a branch office in Tunisia and its head office in the United States is, in computing the Tunisian tax liability of the branch, entitled to deduct a portion of the executive and general administrative expenses incurred in the United States by the head office for purposes of administering the branch. No such deduction is allowed, however, in respect of amounts paid (other than in re-

imbursement of actual expenses) by the permanent establishment to the head office of the enterprise (or any other of its offices) by way of royalties, fees or other similar payments as consideration for the use of patents or other rights, or as commissions for specific services performed or for management, or as interest on moneys lent to the permanent establishment. A reciprocal rule applies for specified payments from the head office (or other office) to the permanent establishment.

Business profits are not attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment for the account of the enterprise. Thus, if a permanent establishment purchases goods for its head office, the business profits attributed to the permanent establishment with respect to its other activities are not increased by a profit element in its purchasing activities. The method of determining profits attributable to a permanent establishment must be applied consistently from year to year, unless there is good and sufficient reason for using an inconsistent method.

Where business profits include items of income that are dealt with separately in other articles of the proposed treaty, those other articles, and not Article 7, generally govern the treatment of those items of income.

The proposed treaty provides that a partner's share of the business profits of a partnership is taxable in the country where the partnership has a permanent establishment.

Finally, the proposed treaty contains a provision designed to permit the tax authorities of either the United States or Tunisia to apply the provisions of the respective country's internal law in determining tax liability in cases where the information available to the competent authority is inadequate to accurately compute the profits of a permanent establishment. Such a determination must be done in a manner which, based on the available information, is consistent with the principles of Article 7 (e.g., allocation of profits on an arm's length basis). In accordance with the Technical Explanation, the Committee understands that the Internal Revenue Service has this authority notwithstanding this special provision.

ARTICLE 8. SHIPPING AND AIR TRANSPORT

As a general rule, the United States taxes the U.S. source income of a foreign person from the operation of ships or aircraft to or from the United States. An exemption from U.S. tax is provided if the income is earned by a corporation that is organized in, or an alien individual who is resident in, a foreign country that grants an equivalent exemption to U.S. corporations and residents. The United States has entered into agreements with a number of countries providing reciprocal tax exemptions for shipping and aircraft income.

Under the proposed treaty, the rights of the two countries to tax income that is derived from the operation of ships or aircraft in international traffic is limited to certain cases. Tunisia is permitted to tax such income only if the place of effective management of the enterprise is in Tunisia, or is aboard a ship whose home harbor is Tunisia or whose operator is a resident of Tunisia. The United

States is permitted to tax this income only if the enterprise is created under the laws of the United States or any State. It is the Committee's understanding that, in effect, each country is permitted to tax income from international shipping or air transport only if the enterprise is a resident of that country for domestic tax purposes. As explained in the Technical Explanation, both countries are permitted to tax such income of a dual resident company, subject to the provisions of the article providing relief from double taxation (Article 23).

These rules also apply to profits derived from the participation in a pool, joint business, or international operating agency.

Article 8 takes precedence over the article on business profits (Article 7). Thus, each country is required to exempt the shipping income of a resident of the other country, even if the income is attributable to a permanent establishment in the first country.

International traffic is any transportation by ship or aircraft, except where the transportation is solely between places in one of the countries (Article 3(1)(g) (General Definitions)).

Profits from the operation of ships or aircraft in international traffic include profits derived from the rental of ships or aircraft, if operated in international traffic by the lessee or if such rental profits are occasional and accessory to the actual operation of ships or aircraft in international traffic. In addition, those profits include income derived from the use, maintenance, or rental of containers, or other related equipment where the containers, equipment, etc. are used in international traffic, if such income is occasional and accessory to the actual operation of ships or aircraft in international traffic. As explained in the Technical Explanation, income derived from container leasing by companies not engaged in international shipping or air transport is covered by the article on business profits (Article 7) or independent personal services (Article 14), as appropriate. Thus, source-country taxation of container leasing income is permitted only if the income is attributable to a permanent establishment or a fixed base in the source country.

Rules similar to the rules provided in Article 8 apply to the taxation of gains from the disposition of ships or aircraft operated in international traffic (Article 13(4)).

ARTICLE 9. ASSOCIATED ENTERPRISES

The proposed treaty, like most other U.S. tax treaties, contains an arm's-length pricing provision, similar to Code section 482, that recognizes the right of each country to make an allocation of income, deductions, credits, or allowances to that country in the case of transactions between related enterprises to reflect the conditions and arrangements that would have been made between independent persons.

For purposes of the proposed treaty, an enterprise is related to another enterprise if either enterprise person owns or controls directly or indirectly the other, or if any third person or persons own or control directly or indirectly both enterprises.

If, pursuant to this article, one country includes in the profits of its resident, and taxes accordingly, profits on which a resident of the other country has been subjected to tax in that other country,

then the other country, is to make a correlative adjustment to the amount of the tax charged on its resident on those profits. In determining the correlative adjustment, the other country is to give due regard to the other provisions of the proposed treaty and, if necessary, the competent authorities of the two countries will consult with each other.

The proposed treaty omits the U.S. model provision stating that this article is not intended to limit any law in either country that permits the distribution, apportionment, or allocation of income, deductions, credits, or allowances between non-independent persons when such law is necessary to prevent evasion of taxes or to reflect clearly the income of those persons. That provision generally clarifies that the United States retains the right to apply its intercompany pricing rules (Code sec. 482) and its rules relating to the allocation of deductions (Code secs. 861, 862, 863, and 864, and applicable regulations). As reflected in the Technical Explanation, the Committee understands that the United States retains the right under the proposed treaty to apply its intercompany pricing and deduction allocation rules, notwithstanding the omission of the standard language.

ARTICLE 10. DIVIDENDS

In general

This article generally reduces to 20 percent the rate of tax that one of the countries can levy on the gross amount of dividends paid to "portfolio" investors of the other country and to 14 percent the rate of tax on dividends paid to "direct" investors. The proposed treaty also permits the branch profits tax and the branch-level tax on excess interest to be imposed at a 14 percent rate. The proposed treaty provides that the dividend recipient's country of residence may also tax the dividend under its internal laws.

U.S. taxation of dividends paid to foreign persons

The United States generally imposes a 30-percent withholding tax on the gross amount of U.S. source dividends (other than dividends paid by an "80/20 company" described in Code section 861(c)) paid to nonresident alien individuals and foreign corporations. The 30-percent tax does not apply if the foreign recipient is engaged in a trade or business in the United States and the dividends are effectively connected with that trade or business. In such a case, the foreign recipient is subject to U.S. tax like a U.S. person at the standard graduated tax rates, on a net basis. For purposes of the 30-percent tax, U.S. source dividends are dividends paid by a U.S. corporation (other than a corporation that has elected status as a possession corporation under Code sec. 936). Also treated as U.S. source dividends for this purpose are certain dividends paid by a foreign corporation, if at least 25 percent of the gross income of the foreign corporation, in the prior three-year period, was effectively connected with a U.S. trade or business. The U.S. tax imposed on dividends paid by a foreign corporation is often referred to as a "second-level" withholding tax.

For taxable years beginning after December 31, 1986, a U.S. branch of a foreign corporation is subject to a branch profits tax in

the United States on any deemed repatriation of the branch's U.S. effectively connected earnings and profits. The branch profits tax rate is 30 percent (but can be reduced or eliminated by treaty), and is levied on the branch's dividend equivalent amount. The branch profits tax provision generally replaces the second-level dividend withholding tax (discussed above) which the United States imposed prior to the 1986 Act.

In addition to the branch profits tax, a foreign corporation is also subject to a branch-level interest tax on "excess interest." For this purpose, "excess interest" means the interest deducted by the foreign corporation in computing its U.S. effectively connected income, to the extent that the deduction exceeds the interest paid by the U.S. trade or business. The branch-level tax on excess interest is an amount equal to the tax the foreign corporation would have paid had a wholly owned U.S. corporation paid it an amount of interest equal to the amount of "excess interest."

Tunisian system for taxing dividends

In the past, Tunisian source dividends generally have been subject to the tax on income from movable capital in Tunisia. This tax has been collected through withholding at source, at a rate of 30 percent with respect to bearer shares, and 20 percent with respect to registered shares. The Committee understands that Tunisia has recently amended its internal laws, and in doing so has reduced (or in some cases eliminated) this tax.

Proposed treaty rules

Under the proposed treaty, dividends paid by a company that is a resident of one country to a resident of the other country are taxable by both countries. The proposed treaty generally limits the rate of tax that the payor's country of residence may impose on dividends paid to a beneficial owner in the other country, however. None of the limitations on taxation of dividends apply to taxation of the company in respect of the profits out of which the dividends are paid. The limitation is 20 percent or 14 percent, depending on the relationship between the payor and the payee. The 14-percent rate of source-country tax applies to dividends if the beneficial owner is a company (other than a partnership) that owns at least 25 percent of the voting stock of the company paying the dividends. The 20-percent rate applies to dividends in all other cases.

The proposed protocol clarifies that the 14-percent rate does not apply to dividends paid by a U.S. regulated investment company (RIC) or real estate investment trust (REIT). Moreover, in the case of dividends paid by a REIT other than to a beneficial owner who is an individual owning a less than 25 percent interest in the REIT, the rate of withholding applicable under U.S. law applies (i.e., 30 percent).

The proposed treaty defines dividends to mean income from shares, "jouissance" shares or "jouissance" rights, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the internal laws of the distributing company's country of residence. According to the proposed protocol, the term "dividends" also includes income

from any income-producing financial transactions, including debt obligations, carrying the right to participate in profits, to the extent so characterized under the internal law of the country in which the income arises.

The limitation contained in the proposed treaty on the rate of withholding tax will not apply if the recipient of the dividend has a permanent establishment or fixed base in the source country and the shares with respect to which the dividend is paid are effectively connected with the permanent establishment or fixed base. In that case, the dividend is taxed as business profits (Article 7) or as income from independent personal services (Article 14), as appropriate. In addition, the saving clause assures that the reduced withholding tax rate does not apply with respect to U.S. source dividends received by U.S. citizens who are resident in Tunisia (Article 22(2)).

Under the proposed protocol, the country in which a corporate resident of the other country has a permanent establishment is authorized to impose a branch profits tax and a branch-level tax on excess interest payments, in accordance with its internal law, on the profits attributable to, or excess interest payments allocable to, the permanent establishment, and on income from real property (Article 6) and related capital gains (Article 13(1)) which are subject to tax in that country. The rates of these branch-level taxes generally are not to exceed 14 percent. In computing net profits which are subject to a branch profits tax, any income tax imposed by the source country on the income of the permanent establishment are allowed as a deduction.

ARTICLE 11. INTEREST

Subject to numerous exceptions (such as those for portfolio interest, bank deposit interest, and short term original issue discount), the United States imposes a 30-percent tax, collected by withholding, on U.S. source interest paid to foreign persons under the same rules that apply to dividends. For purposes of the 30-percent tax, U.S. source interest generally is interest on debt obligations of U.S. persons, other than a U.S. person that meets the foreign business requirements of Code section 861(c) (e.g., an 80/20 company). Also subject to the 30-percent tax is interest paid by the U.S. trade or business of a foreign corporation.

As well as allowing a taxpayer's country of residence to tax interest income, the proposed treaty generally allows the imposition of a withholding tax at source on interest. The proposed treaty limits the rate of tax to 15 percent of the gross amount of the interest, however, in situations where the interest is beneficially owned by a resident of the other country. This 15-percent rate contrasts with the U.S. model position, often not achieved, that interest should be exempt from tax at source.

Certain exceptions apply to the general rule that permits both the residence country and, at a limited rate, the source country to tax interest. First, in cases where interest is derived from sources within one country by the government of the other country or its agency or instrumentality which is exempt from tax in its residence country, such interest is exempt from source-country tax

under the proposed treaty. Second, interest that is beneficially derived by a bank or similar financial institution with respect to an obligation with a maturity of at least seven years is exempt from tax in the source country. Third, source-country tax exemption is granted to interest paid by the Government of Tunisia (or its political subdivisions or local authorities) to a U.S. resident who provided loans to that government, subdivision, or agency.

The proposed treaty defines "interest" as income from debt-claims of every kind, whether or not secured by mortgage, and (unless it is treated as a dividend in accordance with Article 19 (Dividends)) whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and from bonds, debentures, including premiums and prizes attaching to bonds or debentures. Penalty charges for late payment are not treated as interest under the proposed treaty.

As in the case of dividends, if interest is paid on debt that is effectively connected with a permanent establishment or fixed base in the source country, the interest is taxed as business profits (Article 7) or as income from independent personal services (Article 14), as the case may be. That is, the 15-percent rate limitation and exemptions of this article do not apply. In addition, the reduced withholding tax rate does not apply with respect to U.S. source interest received by U.S. citizens who are resident in Tunisia (Article 22(2)).

The proposed treaty provides a source rule for interest. Interest is sourced within a country if the payor is the government of that country, including its political subdivisions or local authorities, or a resident of that country. If, however, the interest is borne by a permanent establishment or fixed base that the payor has in one of the treaty countries and the indebtedness was incurred in connection with that permanent establishment or fixed base, interest has its source in that country, regardless of the residence of the payor. Generally, this is consistent with U.S. source rules (Code secs. 861 and 862) which provide as a general rule that interest income is sourced in the country in which the payor is resident, and with the effect of the Code provision that taxes similarly to U.S. source interest income the interest paid by the U.S. trade or business of a foreign corporation.

The proposed treaty addresses the issue of interest charges between related parties by providing that the amount of interest for purposes of applying this article is the amount of arm's-length interest. Where any amount designated as interest paid by a person to any related person (Article 9) exceeds an amount which would have been paid to an unrelated person, the proposed treaty's interest provisions apply only to so much of the interest as would have been paid to an unrelated person. The excess payment may be taxed by each country according to its own law, including the other provisions of the proposed treaty where applicable. For example, excess interest paid to a parent corporation might be treated as a dividend under local law and thus be entitled to the benefits of Article 10 of the proposed treaty.

ARTICLE 12. ROYALTIES

Under the same system that applies to dividends and interest, the United States imposes a 30-percent withholding tax on non-effectively connected U.S. source royalties paid to foreign persons. Generally, royalties are from U.S. sources if they are for the use of property located in the United States. U.S. source royalties include royalties for the use of, or the right to use, intangible assets in the United States.

Tunisia generally imposes a 26.4-percent withholding tax (or in some cases, a 21-percent withholding tax) on Tunisian source royalties paid to nonresident persons.

Under the proposed treaty, royalties derived by a resident of one country from sources within the other country (the "source country") generally are taxable by both the country of residence and the source country; however, the source-country tax rate may not exceed a rate specified by the proposed treaty. Under the saving clause, the reduced withholding tax rate does not apply with respect to U.S. source royalties received by U.S. citizens who are resident in Tunisia (Article 22(2)).

The proposed treaty provides that a maximum source-country tax rate of 15 percent applies to payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, (including cinematographic film or films or tapes used for radio or television broadcasting). In addition, this rate applies to payments of any kind made as consideration for the use of, or the right to use, patents, trademarks, designs, models, plans, secret processes or formulae, or for information concerning industrial, commercial, or scientific experience. Also taxed at a 15-percent rate are gains derived from the sale, exchange, or other disposition of any such property or rights to the extent that the amounts realized on such disposition are contingent on the productivity, use, or disposition of the property or rights.

A maximum source-country tax rate of 10 percent applies to royalties for the use of, or the right to use, industrial, commercial, or scientific equipment, but excluding ships, aircraft, or containers used in international traffic. (Payments for use of such vessels are taxable only under Articles 7 (Business Profits), 8 (Shipping and Air Transport), or 14 (Independent Personal Services). The 10-percent rate also applies to payments of any kind received by a resident of one of the countries as remuneration for technical or economic studies, wherever prepared, which are paid out of public funds of the other country (or a political subdivision or local authority), or remuneration for the performance of accessory technical assistance for the use of property or rights described in this paragraph to the extent that such assistance is performed in the country where the payment or the property or right has its source.

As in the case of dividends and interest, if the property or right giving rise to the royalty is effectively connected with a permanent establishment or a fixed base, the royalty is taxed as business profits (Article 7) or as income from independent personal services (Article 14), as appropriate.

As in the case of interest, if a royalty is paid between related persons (Article 9) and exceeds an arm's-length amount, the excess

is not treated as a royalty, but may be taxed by each country according to its own law, including the other provisions of the proposed treaty where applicable. For example, excess royalties paid to a parent corporation may be treated as a dividend under local law and thus may be entitled to the benefits of Article 10 of the proposed treaty.

For purposes of the proposed treaty, royalties are sourced in the country in which the property giving rise to the royalty payment is used. In the case of studies, royalties paid by a treaty country are sourced in that country.

ARTICLE 13. CAPITAL GAINS

Generally, gain realized by a nonresident alien or a foreign corporation from the sale of a capital asset is not subject to U.S. tax unless the gain is effectively connected with the conduct of a U.S. trade or business or, in the case of a nonresident alien, he or she is physically present in the United States for at least 183 days during the taxable year. Under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), as amended, however, a nonresident alien or foreign corporation is taxed by the United States on gain from the sale of a U.S. real property interest as if the gain was effectively connected with a trade or business conducted in the United States. "U.S. real property interests" include interests in certain corporations holding U.S. real property.

The proposed treaty generally provides that gains derived by a resident of one country are exempt from tax by the other country. The general exemption does not apply in three situations.

First, a resident of one country who derives gains from the sale, exchange, or other disposition of real property referred to in Article 6 (Income from Real Property) that is situated in the other country (the "source country") is not exempt from tax by the source country with respect to such gains. For purposes of the proposed treaty, a U.S. real property interest (for example, stock in a U.S. real property holding company) is considered real property that is situated in the United States. This provision allows the United States to tax any transaction of a Tunisian resident taxable under Code section 897.

Second, gains on the sale, exchange, or other disposition of property that forms a part of the business property of a permanent establishment or a fixed base (including gains on the disposition of the permanent establishment or the fixed base itself) are not exempt from tax in the country where the permanent establishment or fixed base is located. These gains are taxed in that country as business profits (Article 7) or income from independent personal services (Article 14), as appropriate. In addition, as provided in the proposed protocol, a country may also tax gain attributable to a permanent establishment or fixed base even if payments are deferred until after the permanent establishment or fixed base no longer exists. This provision is consistent with Code section 864(c)(6). The tax imposed under Code section 864(c)(7), which allows the United States to tax a disposition of property which occurs subsequent to the time it was attributable to a U.S. trade or business, is not permitted by the proposed treaty or protocol. The

Committee understands that Tunisia does not have an internal rule similar to Code section 864(c)(7).

Third, gain derived by an enterprise from the disposition of certain property used in international shipping and air transportation operations is taxable in Tunisia only if the place of the enterprise's effective management is in Tunisia; the United States may tax such gain only if the enterprise is created under the laws of the United States or any State.

The article on gains is subject to the saving clause (Article 22(2)). Therefore, as a general rule, the United States may tax its citizens and residents on gains without regard to the provisions contained in the proposed treaty.

ARTICLE 14. INDEPENDENT PERSONAL SERVICES

The United States taxes the income of a nonresident alien individual at the regular graduated tax rates if the income is effectively connected with the conduct of a trade or business in the United States by the individual. (See discussion of U.S. taxation of business profits under Article 7 (Business Profits).) The performance of personal services within the United States can be a U.S. trade or business (Code sec. 864(b)).

The proposed treaty limits the right of a country to tax income from the performance of personal services by a resident of the other country. Under the proposed treaty, income from the performance of independent personal services is treated separately from salaries, wages, and similar remuneration received by employees.

Under the proposed treaty, income of an individual resident in one country from the performance of personal services in an independent capacity in the other country (the "source country") is exempt from tax in the source country unless (1) the individual is present in the source country for more than 183 days in the taxable year concerned, (2) the individual has a fixed base regularly available to him or her in that country for the purpose of performing the activities, or (3) the gross income derived by the individual during the taxable year, from source country residents for services performed in the source country, exceeds \$7,500 or the equivalent amount in Tunisian dinars. If any of these three criteria are satisfied, the source country can tax the individual's income derived from independent personal services performed in that country; however, if only the second criterion is met, only that portion of the individual's income from independent personal services that is attributable to his or her fixed base in that country may be so taxed. In any of the three cases, the country of residence may also tax that income, subject to the proposed treaty's provisions for relief from double taxation (Article 23).

For purposes of this article, performance of personal services in an independent capacity includes especially (but is not limited to) independent scientific, literary, artistic, educational, or teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists, and accountants.

This article is modified somewhat by the article on directors' fees (Article 16).

The article on independent personal services is subject to the provisions of the saving clause (Article 22(2)). Therefore, as a general rule, the United States may tax its citizens and residents on income derived from the performance of independent personal services without regard to the provisions contained in the proposed treaty. For example, in the case of such income earned by a U.S. citizen residing in Tunisia, the U.S. tax is not limited by the rules contained in Article 14.

ARTICLE 15. DEPENDENT PERSONAL SERVICES

Under the Code, the income of a nonresident alien individual derived from the performance of personal services in the United States is not taxed if the individual is present in the United States for less than 90 days during a taxable year, the compensation is less than \$3,000, and the services are performed as an employee of a foreign person not engaged in a trade or business in the United States or for a foreign office or place of business of a U.S. person.

Under the proposed treaty, income derived from labor or personal services performed as an employee in one country (the "source country") by a resident of the other country are not taxable in the source country if three requirements are met: (1) the individual is present in the source country for no more than 183 days during the taxable year; (2) the employer is not a resident of the source country; and (3) the compensation is not borne or reimbursed by a permanent establishment of the employer in the source country. If these requirements are not all met, the source country may tax the individual's income derived from dependent personal services. The limited source-country tax exemption contained in the proposed treaty is similar to that provided in the U.S. model.

Compensation derived by an employee aboard a ship or aircraft operated in international traffic by an enterprise is taxable by Tunisia only if the place of effective management of the enterprise is in Tunisia; and is taxable by the United States only if the enterprise is created under the laws of the United States or any State.

The rules of this article are modified in some respects for directors' fees (Article 16), pensions (Article 18), and compensation derived as a government employee (Article 19).

The article on dependent personal services is subject to the saving clause (Article 22(2)). Therefore, as a general rule, the United States may tax its citizens and residents on employment income without regard to the provisions contained in the proposed treaty. For example, in the case of such income earned by a U.S. citizen residing in Tunisia, the U.S. tax is not limited by the rules contained in Article 15.

ARTICLE 16. DIRECTORS' FEES

The proposed treaty contains a special rule for directors' fees. If an individual who is a resident of one country serves as a member of the board of directors of a company that is a resident of the other country, the country of the company's residence may tax him or her on the director's fees derived by that person if those fees are treated by that country as a nondeductible distribution of profits by the corporation. This rule does not cover fixed or contingent

payments derived by the individual in his or her capacity as an officer or employee of the corporation. Fees earned by a director that do not meet the specific criteria detailed above are covered by either the article on independent personal services (Article 14) or dependent personal services (Article 15), as appropriate. This article is similar to the corresponding article in the U.S.-Belgium income tax treaty.

ARTICLE 17. ARTISTES AND ATHLETES

The proposed treaty contains a separate set of rules that apply to the taxation of income earned with respect to services performed by public entertainers (such as theater, motion picture, radio, or television "artistes" or musicians) and athletes. These rules apply notwithstanding the other provisions dealing with the taxation of income from personal services (Articles 14 and 15) and are intended, in part, to prevent entertainers and athletes from using the proposed treaty to avoid paying any tax on their income earned in one of the countries.

Under the proposed treaty, one country (the "source country") may tax entertainers and athletes who are residents of the other country on the income derived from their personal activities performed in the source country if their gross receipts (including reimbursed expenses or expenses borne on their behalf) exceed \$7,500 or its equivalent in Tunisian dinars for the taxable year concerned. The comparable annual total in the U.S. model treaty is \$20,000 (including reimbursed expenses). Under this provision, for example, if a Tunisian entertainer does not maintain a fixed base in the United States, but performs in the United States (as an independent contractor) during a taxable year for total compensation (including reimbursed expenses) of \$7,400, the United States can not tax that income. If however, the entertainer's total compensation for that year is \$7,600, the full \$7,600 (less appropriate deductions) is subject to U.S. tax.

In addition, the proposed treaty provides that if income in respect of activities performed by an entertainer or athlete in his or her capacity as such accrues not to the entertainer or athlete, but to another person, that income may be taxable by the source country. (This provision applies notwithstanding the articles on business profits, independent personal services, and dependent personal services (Articles 7, 14, and 15).) This provision is intended to prevent performers and athletes from avoiding tax in the source country by routing the compensation for their services through a third person such as a personal holding company or trust located in a country that would not tax the income. For purposes of this rule, income of an entertainer or athlete is deemed not to accrue to another person if it is established that neither the entertainer or athlete, nor any related persons, participate directly or indirectly in the profits of such other person. A participation in profits includes the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions and other distributions.

The artistes and athletes article of the proposed treaty is subject to the provisions of the saving clause (Article 22(2)). Therefore, as a general rule, the United States is permitted to tax its citizens and

residents on income earned as an entertainer or athlete without regard to the provisions contained in the proposed treaty. For example, in the case of such income earned by a U.S. citizen resident in Tunisia, the U.S. tax on that income is not limited by the provisions of Article 17.

ARTICLE 18. PENSIONS, ETC.

Under the proposed treaty, pensions and other similar remuneration paid to an individual resident of one country in consideration of past employment in the other country (the "source" country) are exempt from tax by the source country. This rule is similar to the rule contained in the U.S. model. The term "pension" is not defined by the proposed treaty; thus, the definition of that term is left up to the local laws of the two countries. This article does not apply to a pension paid with respect to government service (Article 19).

Social security payments and similar payments (including, for example, payments under the Railroad Retirement Act) paid by one country to a resident of the other country are taxable by both countries under the proposed treaty. Under this provision, the United States is permitted to tax U.S. social security payments to U.S. persons residing in Tunisia. To the extent that it does so, thereby causing the payments to be taxed in both countries, Tunisia is required by Article 23 to grant the taxpayer relief from double taxation in the form of a credit for taxes paid to the United States. This rule safeguards the United States' right under the Social Security Amendments of 1983 to tax a portion of U.S. social security benefits received by nonresident individuals, while protecting any such individuals residing in Tunisia from double taxation.

The proposed treaty provides that annuities are taxable only in the recipient's country of residence. "Annuities" are defined as stated sums paid periodically at stated times during life or during a specified number of years, under a contractual obligation.

In addition, the proposed treaty provides that alimony payments made by a resident of one of the countries to a resident of the other country are exempt from tax in the payor's country of residence. "Alimony" is defined as periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, which payments are taxable to the recipient under the laws of his or her country of residence.

The proposed treaty further provides that periodic child support payments made pursuant to a written separation agreement or decree of divorce, separate maintenance, or compulsory support, paid by a resident of one of the countries to a resident of the other country are exempt from tax in both countries.

These rules are subject to the saving clause (Article 22(2)). Thus, for example, a country may tax alimony received by a citizen of that country residing in the other country.

ARTICLE 19. GOVERNMENTAL FUNCTIONS

Under the proposed treaty, remuneration (other than a pension) paid from public funds of one country (or its political subdivisions or local authorities) to an individual who is a citizen of that coun-

try for labor or personal services performed in the discharge of governmental functions is exempt from tax by the other country. A similar rule is found in the U.S. model.

As a general rule, any pension paid out of government funds of one of the countries to a resident of the other country individual in respect of labor or personal services rendered to that country in the discharge of governmental functions is taxable only by the recipient's country of residence. Thus, for example, if the U.S. Government makes pension payments to a resident of Tunisia, generally only Tunisia may tax those payments. This rule is a departure from the U.S. model, and represents a concession to Tunisia's position that its residents deriving pensions (whether from public or private sources) should be taxed on the same basis without regard to where the pension originates. As an exception to this general rule, the country whose government makes such payments is permitted to tax those payments if they are made to a citizen of the paying country.

The rules of this article generally are subject to the saving clause (Article 22(2)), except in the case of a person who is not a citizen of, or an immigrant in, the country conferring benefits to that person under Article 19.

The proposed treaty clarifies that this article does not apply to payments made in respect of services rendered in connection with a trade or business carried on by a government. In such a case, the provisions of the articles dealing with personal services (Articles 14 and 15) or artistes and athletes (Article 17) apply, as appropriate.

ARTICLE 20. STUDENTS AND TRAINEES

The proposed treaty provides special host-country tax exemptions for income of a resident of one country who visits the other as a student, apprentice, or trainee. These treaty exemptions differ in some respects from those provided in the U.S. model. They are similar to the exemptions incorporated in a number of older U.S. income tax treaties.

Under the proposed treaty, an individual who is a resident of one country immediately before entering the other country (the "host country"), and who is present in the host country for the purpose of his or her full-time education or training is exempt from host-country tax on certain items for a period not to exceed five years beginning with that person's date of arrival in the host country. The items to which the exemption applies include (1) payments arising outside of the host country for the purpose of the individual's full-time education or training, (2) a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization for the purposes of studying or doing research, and (3) income from personal services performed in an amount not in excess of \$4,000 or its equivalent in Tunisian dinars for any taxable year. According to the Technical Explanation, any income in excess of the \$4,000 threshold is taxable by the host country in accordance with domestic law, taking into account any personal exemptions and deductions allowable under domestic law.

The rules of this article generally are subject to the saving clause (Article 22(2)), except in the case of a person who is not a citizen of or an immigrant in the country conferring benefits to that person under Article 20.

ARTICLE 21. OTHER INCOME

This article is a catch-all article intended to cover items of income not specifically covered in other articles, and to assign the right to tax third-country income to only one of the countries. It applies to income from third countries as well as income from the United States and Tunisia.

As a general rule, items of income not otherwise dealt with in the proposed treaty that are derived by residents of a country are taxable only by that country. The proposed treaty thus gives the United States the sole right to tax income arising in a third country and paid to a resident of the United States. If the income is attributable to a permanent establishment or fixed base in the treaty country (the "source country") that is not the residence country, however, the source country may also tax it. In addition, income from real property that is not subject to another treaty provision is taxable only in the country of residence of the person earning the income, whether or not the real property income is attributable to a permanent establishment or fixed base in the other treaty country. The effect of this provision is to allow only the residence country to tax income from real property located in a third country, even if that income somehow is attributable to a permanent establishment or fixed base in the treaty country not of residence.

This provision is subject to the saving clause (Article 22(2)). Thus, U.S. citizens who are Tunisian residents would continue to be subject to U.S. taxation on their worldwide income.

ARTICLE 22. GENERAL RULES

Restriction of domestic-law benefits

The proposed treaty contains the rule found in other U.S. tax treaties clarifying that its provisions do not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance otherwise accorded by the domestic laws of either country or any other agreement between the two countries. Thus, the proposed treaty applies only where it benefits taxpayers.

Saving clause

Like all U.S. income tax treaties, the proposed treaty is subject to a "saving clause." Under this clause, with exceptions described below, the United States reserves the right to tax its citizens and residents (as defined in the treaty) and Tunisia reserves the right to tax its citizens and residents (as defined in the treaty), notwithstanding any provision of the proposed treaty. By reason of the saving clause, the United States generally continues to tax its citizens who are residents of Tunisia as if the proposed treaty were not in force. "Residents," for purposes of the proposed treaty (and thus for purposes of the saving clause), include corporations and other entities as well as individuals (Article 4 (Fiscal Domicile)).

Under Code section 877 ("Expatriation to avoid tax"), a former U.S. citizen whose loss of citizenship had as one of its principal purposes the avoidance of U.S. income, estate, or gift taxes, is, in certain cases, subject to U.S. tax for a period of 10 years following the loss of citizenship. The proposed treaty contains the standard provision found in the U.S. model and most recent treaties specifically reserving the United States' right to tax such former citizens. (Even absent a specific provision, the Internal Revenue Service has taken the position that the United States retains the right to tax former citizens resident in the treaty partner (Rev. Rul. 79-152, 1979-1 C.B. 237).)

Exceptions to the saving clause are provided for the benefits conferred by the articles dealing with correlative adjustments to be made by one country in accordance with adjustments made by the other country in the case of certain transactions between related persons (Article 9(2)), the general rule prohibiting the proposed treaty from restricting benefits conferred under domestic law (Article 22(1)), relief from double taxation (Article 23), non-discrimination (Article 24), and mutual agreement procedures (Article 25). The benefits of those articles are conferred by each country on its own citizens and residents as well as the citizens and residents of the other country. In addition, the benefits conferred by the articles dealing with the taxation of income received by government employees (Article 19) and students and trainees (Article 20) are provided by each country to its residents who are neither citizens of, nor have immigrant status in, that country. A person has "immigrant status" in the United States if he or she has been admitted to the United States as a permanent resident under U.S. immigration laws (that is, he or she holds a "green card").

ARTICLE 23. RELIEF FROM DOUBLE TAXATION

Background

One of the two principal purposes for entering into an income tax treaty is to limit double taxation of income earned by a resident of one of the countries that is subject to tax in the other country. The United States seeks unilaterally to mitigate double taxation by generally allowing U.S. taxpayers to credit the foreign income taxes that they pay against the U.S. tax imposed on their foreign source income. A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax on U.S. source income. Therefore, the foreign tax credit provisions contain a limitation that ensures that the foreign tax credit offsets U.S. tax on foreign source income only. Moreover, the foreign tax credit provisions contain rules that prevent U.S. persons from converting U.S. source income into foreign source income through the use of an intermediate foreign payee.

The foreign tax credit limitation generally is computed on a worldwide consolidated basis. Hence, all income taxes paid to all foreign countries are combined to offset U.S. taxes on all foreign income. Separate limitations on the foreign tax credit are provided for oil and gas extraction income, passive income, high withholding tax interest, financial services income, shipping income, dividends from noncontrolled section 902 corporations, DISC dividends, FSC

dividends, and taxable income of a FSC attributable to foreign trade income.

Foreign tax credits generally cannot exceed 90 percent of the pre-foreign tax credit tentative minimum tax (determined without regard to the net operating loss deduction). However, no such limitation will be imposed on a corporation if more than 50 percent of its stock is owned by U.S. persons, all of its operations are in one foreign country with which the United States has an income tax treaty with information exchange provisions, and certain other requirements are met. The 90-percent alternative minimum tax foreign tax credit limitation, enacted in 1986, overrode contrary provisions of then-existing treaties.

An indirect or "deemed paid" credit is also provided. A U.S. corporation that owns 10 percent or more of the voting stock of a foreign corporation and receives a dividend from the foreign corporation (or an inclusion of the foreign corporation's income) is deemed to have paid a portion of the foreign income taxes paid or deemed paid by the foreign corporation on its accumulated earnings. The taxes deemed paid by the U.S. corporation are included in its total foreign taxes paid for the year the dividend is received and go into the relevant pool or pools of separate limitation category taxes to be credited.

Unilateral efforts to limit double taxation are imperfect. Because of differences in rules as to when a person is taxable on business income, a business may be taxed by two countries as if it was engaged in business in both countries. Also, a corporation or individual may be treated as a resident of more than one country and be taxed on a worldwide basis by both.

Part of the double taxation problem is dealt with in other articles that limit the right of a source country to tax income. This article provides further relief where both Tunisia and the United States would still tax the same item of income. This article is not subject to the saving clause, so that the country of citizenship or residence waives its overriding taxing jurisdiction to the extent that the article applies.

The proposed treaty provides separate rules for relief from double taxation for the United States and Tunisia.

United States

Under the proposed treaty, the United States provides its citizens and residents with a foreign tax credit against their U.S. income tax for the appropriate amount of Tunisian tax paid. The credit is computed in accordance with the provisions and subject to the limitations of U.S. law applicable to the year in question (as they may be amended from time to time without changing the general principle of providing a foreign tax credit).⁷ The credit may not exceed the limitations provided by U.S. law for the taxable year.

The proposed treaty also allows the U.S. indirect foreign tax credit to a U.S. corporate shareholder of a Tunisian company receiving dividends from that company if the U.S. corporation owns

⁷ For example, the Committee understands that, for purposes of the U.S. alternative minimum tax, the foreign tax credit allowable is limited, under the proposed treaty, to 90 percent of the pre-credit liability for such tax, as provided under U.S. law.

10 percent or more of the voting stock of the Tunisian company. The credit is allowed for Tunisian income taxes paid by or on behalf of the Tunisian company on the profits out of which the dividends are paid.

All of the Tunisian taxes listed in Article 2(2)(b) and 2(3) are considered creditable taxes under this provision.

Tunisia

The proposed treaty requires that Tunisia provide its residents a credit against their Tunisian tax for the appropriate amount of income taxes paid to the United States. The amount of this credit is limited, however, to that portion of the Tunisian pre-credit income tax that is attributable to the income which is taxable in the United States.

Source rules

For purposes of applying both the U.S. and Tunisian foreign tax credits under the proposed treaty, a general source rule is provided. This general rule states that income derived by a resident of one country which, under the proposed treaty, is subject to tax in the other country (other than solely by reason of the taxpayer's citizenship), is sourced in the other country. For purposes of the foreign tax credit provided by the United States, the Committee understands that, as set forth in the Technical Explanation, the U.S. foreign tax credit limitations take into account such source rules of U.S. law as apply for the purposes of determining the foreign tax credit limitations.

For example, the 1984 Act amended the foreign tax credit limitation rules to prevent U.S. persons from treating as foreign source income dividends, interest, and certain other income derived through a foreign corporation, a significant part of whose income arose in the United States. As mentioned above, the proposed treaty provides that the United States is required to credit taxes paid to Tunisia only in accordance with the provisions and subject to the limitations of the law of the United States, as in force from time to time. Furthermore, the proposed treaty provides that in applying the United States credit in relation to taxes paid to Tunisia, the treaty's source rule applies, subject to such source rules in domestic law as apply solely for the purposes of limiting the foreign tax credit. Because the 1984 Act change is a U.S.-law source rule that applies for purposes of limiting the foreign tax credit, it is understood by the Committee that the Treasury Department interprets the proposed treaty not to override the 1984 amendment.

ARTICLE 24. NON-DISCRIMINATION

The proposed treaty contains a nondiscrimination article relating to all taxes of every kind imposed by one of the countries or by their political subdivisions or local authorities. It is similar to the nondiscrimination article in the U.S. model treaty and to provisions that have been embodied in other recent U.S. income tax treaties.

Generally under the proposed treaty, one country (the "source country") may not discriminate by imposing more burdensome

taxes or related requirements on citizens of the other country (who are resident in the source country) than it imposes on its own resident citizens in the same circumstances. Consistent with the Technical Explanation, however, the Committee understands that for purposes of U.S. tax, a U.S. national who is not a resident of the United States and a Tunisian national who is not a resident of the United States are not in the same circumstances, because the U.S. national is subject to U.S. tax on his or her worldwide income. Contrary to the corresponding provision in the U.S. model, this nondiscrimination rule is limited to persons who are resident in either the United States or Tunisia.

The proposed treaty adopts the OECD model treaty definition of "nationals." Nationals are individuals possessing the citizenship of the United States or Tunisia and all legal persons deriving their status as such from the laws in force in the United States or Tunisia. Under the U.S. model treaty, by comparison, only U.S. citizens qualify as U.S. nationals for purposes of obtaining nondiscrimination benefits.

Generally, the proposed treaty prohibits a source country from imposing less favorable taxation on permanent establishments of residents of the other country than it imposes on its comparable residents carrying on the same activities. This rule does not limit a source country's ability to levy a tax on branch-level profits or interest of a permanent establishment of a resident of the other country (Article 10(7)).

Each country is required (subject to the arm's-length pricing rules of Articles 9(1) (Associated Enterprises), 11(8) (Interest), and 12(5) (Royalties)) to allow its residents to deduct interest, royalties, and other disbursements paid by them to residents of the other country under the same conditions that it allows deductions for such amounts paid to residents of the same country as the payor.

The rule of nondiscrimination also applies to corporations of one country that are owned in whole or in part by residents of the other country. A corporation resident in one country, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other country, is not to be subjected in its country of residence to any taxation or any connected requirements that are other or more burdensome than the taxation and connected requirements that the corporation's residence country imposes or may impose on other similar enterprises resident in the first country.

Under this article of the proposed treaty, a country is not required to grant to residents of the other country the personal allowances, reliefs, or reductions for taxation purposes on account of civil status or family responsibilities that it grants to its own residents.

The saving clause (Article 22(2)) which allows the country of residence or citizenship to tax income notwithstanding certain treaty provisions does not apply to the nondiscrimination article.

ARTICLE 25. MUTUAL AGREEMENT PROCEDURE

In general

The proposed treaty contains the standard mutual agreement provision which authorizes the competent authorities of the United States and Tunisia to consult together in an attempt to alleviate individual cases of double taxation not in accordance with the proposed treaty. The saving clause of the proposed treaty does not apply to this article, so that the application of this article may result in waiver (otherwise mandated by the proposed treaty) of taxing jurisdiction by the country of citizenship or residence.

Under the proposed treaty, a resident of one country who considers that the actions of one or both of the countries will cause him or her to pay tax not in accordance with the proposed treaty may present the case to the competent authority of the country of his or her residence, or in cases where the relief from double taxation article applies (Article 23), an aggrieved person may also present his or her case to the competent authority of the country of which that person is a resident or national. The competent authority then determines whether the claim has merit. If it determines that the claim does have merit, the competent authority will endeavor to seek a solution independently or come to an agreement with the competent authority of the other country with a view to the avoidance of taxation that is contrary to the provisions of the proposed treaty.

In the event that the competent authorities reach an agreement under this mutual agreement article, the proposed treaty provides for the waiver of the statute of limitations of either country so as to permit the issuance of a refund or credit notwithstanding the statute of limitations. However, this article does not authorize the imposition of additional taxes after the statute of limitations has run.

The competent authorities may also consult together to endeavor to mutually agree on any difficulty or doubt arising in applying the proposed treaty; for example, in the case of an uncertain interpretation or application of the proposed treaty. In addition, they may consult together for the purpose of eliminating double taxation in cases not provided for in the proposed treaty.

The proposed treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of this mutual agreement article. When it seems advisable for the purpose of reaching an agreement, they may meet for an oral exchange of opinions. These provisions clarify that it is not necessary to go through normal diplomatic channels in order to discuss problems arising in the application of the proposed treaty. They also remove any doubt as to restrictions that might otherwise arise by reason of the confidentiality rules of the United States or Tunisia.

Limitation on benefits

Article 25 also contains rules to prevent "treaty-shopping" by persons (other than individuals) not intended to benefit from the proposed treaty. In order to receive treaty benefits, a person other than an individual must satisfy one of the following three tests.

Under the first test, more than 50 percent of the beneficial interest in a person that is a resident of one of the countries (or, in the case of a company, more than 50 percent of the number of shares of each class of the company's stock) must be owned, directly or indirectly, by any combination of the following persons: individuals who are residents of the United States or Tunisia, the government of either country (or their political subdivisions or local authorities), or U.S. citizens. Moreover, the income of such person must not be used in substantial part, directly or indirectly, to meet liabilities (including deductible expenses such as interest and royalty payments) to persons other than those listed above. The purpose of this latter requirement, generally referred to as a "base erosion" rule, is to prevent residents of third countries from utilizing a company resident in either the United States or Tunisia which meets the ownership requirements, but pays out a substantial portion of its income to such third country residents in the form of deductible expenses.

Under the second test, benefits provided by the proposed treaty are authorized to persons (regardless of the place of residence of their owners) that carry on an active business in the treaty country of which they are residents and derive income from the other treaty country in connection with that active business. Under this test, making or managing investments does not constitute an active business unless carried on by a bank or insurance company in its normal course of business.

The third test permits treaty benefits to be obtained by a company that is a resident of either the United States or Tunisia, and whose principal class of shares is substantially and regularly traded on a recognized stock exchange (e.g., the NASDAQ System, any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934, the Tunisian stock exchange (Bourse de Valeurs Mobilières), and any other exchange agreed upon by the competent authorities of the two countries).

Prior to any case where a person is to be denied benefits under the proposed treaty, the competent authorities of the two countries are required to consult with one another. According to the Technical Explanation, this rule does not imply that an agreement must be reached by the competent authorities; rather, it is intended to place a requirement on a competent authority to notify the other of its decision to limit treaty benefits, and of the reason for that decision.

In a case where a person fails all three tests discussed above, it may, nevertheless, be granted treaty benefits if the competent authority of the country in which the person's income arises so determines. This rule provides the competent authorities with some flexibility if a case arises where the tests described above cause an unintended denial of benefits.

ARTICLE 26. EXCHANGE OF INFORMATION

Article 26 forms the basis for cooperation between the two countries in their attempts to deal with avoidance or evasion of their respective taxes and to obtain information so that they can proper-

ly administer the proposed treaty. It is similar to the corresponding article of the U.S. model treaty but differs from the U.S. model in certain respects.

The proposed treaty provides for the exchange of information that is pertinent to carrying out the provisions of the proposed treaty or the provisions of the domestic laws of the two countries concerning taxes to which the proposed treaty applies. Similar to the U.S. model, the proposed treaty provides that third-country residents are covered by the exchange of information rules.

Any information exchanged under this article is to be treated as secret in the same manner as information obtained under the domestic laws of the country which receives the information. Exchanged information may be disclosed only to persons (including courts and administrative bodies) concerned with the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes to which the proposed treaty applies. The proposed treaty further provides that such persons may use the information only for the purposes specified in the proposed treaty. In addition, however, they may disclose the information in public court proceedings or judicial decisions. Persons concerned with the administration of taxes include legislative bodies involved in oversight of the administration of taxes, including their agents such as, for example, the U.S. General Accounting Office, with respect to such information as they consider to be necessary to carry out their oversight responsibilities.

The proposed treaty contains limitations on the obligations of the countries to supply information. A country is not required to carry out administrative measures at variance with its laws and administrative practices or to supply information which is not obtainable under its laws or in the normal course of its administration. Moreover, a country is not required to supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

Upon an appropriate request for information by one country, the requested country is to obtain the information to which the request relates in the same manner and to the same extent as if its tax were at issue.

The proposed treaty obligates the competent authority of each country to notify the competent authority of the other country of the publication by its respective country of any material concerning the application of the proposed treaty, including legislation, regulations, rulings, or judicial decisions.

ARTICLE 27. DIPLOMATIC AGENTS AND CONSULAR OFFICERS

The proposed treaty contains the usual provision stating that it is not to affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or the provisions of special agreements. This provision is intended to make clear that the proposed treaty will not defeat any exemption from tax that a host country may otherwise grant unilaterally or by agreement to the income of diplomatic officials of the other country.

Unlike the corresponding provision found in the U.S. model and most U.S. treaties, this provision is fully subject to the saving clause.

ARTICLE 28. ENTRY INTO FORCE

The proposed treaty is to be ratified and instruments of ratification exchanged in Washington, D.C. as soon as possible. The proposed treaty will enter into force upon the exchange of the instruments of ratification. It takes effect with respect to taxes withheld at source for amounts paid or credited on or after the earlier of the first day of January following the exchange of instruments of ratification or the first day of the fourth month following the exchange of instruments of ratification. With respect to other taxes, the proposed treaty takes effect for taxable years ending on or after December 31st of the year during which the exchange of instruments of ratification takes place.

ARTICLE 29. TERMINATION

The proposed treaty is to remain in force indefinitely, but either country may terminate it at any time after five years from its entry into force by giving at least six months' notice, through diplomatic channels, prior to the end of any calendar year. If a termination occurs, it is effective with respect to income of calendar or taxable years beginning (or, in the case of taxes payable at the source, payments made) on or after the January 1st next following the expiration of the six-month period.

EXCHANGE OF NOTES

In notes exchanged by the two countries on the date of signing of the proposed treaty, it was stated that during the course of the negotiations leading to the conclusion of the treaty, representatives of the Tunisian Republic emphasized the importance of increased capital flows to Tunisia and requested that a "tax sparing" credit be included in the treaty as an incentive to U.S. investment in Tunisia. The United States delegation did not agree to this request because it is contrary to the policy of the United States to include tax sparing provisions in its income tax treaties. However, the notes exchanged provide assurance that, should the United States change its policy and include a tax sparing provision in an income tax treaty with another country (which the United States has not done), discussions between the United States and Tunisia would be reopened with a view to extending the same benefit to investment in Tunisia.

IX. TEXT OF THE RESOLUTION OF RATIFICATION

Resolved (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention between the Government of the United States of America and the Government of the Tunisian Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the Convention), together with a related exchange of notes, signed at Washington on June 17, 1985 (Treaty

Doc. 99-13), and to the Supplementary Protocol to the Convention, signed at Tunis on October 4, 1989 (Treaty Doc. 101-9).

